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REPORT OF THE COMMISSION ON ITS NINETEENTH SESSION

Draft report

Addendum

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Chapter ___

GENERAL DISCUSSION ON TRANSNATIONAL CORPORATIONS IN THE WORLD ECONOMY AND TRENDS IN FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

1. The Commission considered item 3 of its agenda at the 1st to 3rd meetings, on 5 and 6 April 1993. It had before it the following documents:

(a) Report of the Secretary-General on trends in foreign direct investment (E/C.10/1993/2);

(b) Report of the Secretary-General on the growth of foreign direct investment in the 1980s: trend or bulge? (E/C.10/1993/3);

(c) Report of the Secretary-General on the emergence of integrated international production (E/C.10/1993/4);

(d) Report of the Secretary-General on the universe of transnational corporations (E/C.10/1993/11).

2. In his opening statement, the Chief of the Research and Policy Analysis Branch of the Transnational Corporations and Management Division stated that the 1980s, especially the second half of the decade, had been a period of

unsurpassed growth of foreign direct investment. He mentioned that in 1991 and perhaps in 1992, there had been a decline in world-wide investment flows for the first time since 1982 and he attributed this to the slow growth and recession in the developed economies, especially in the largest home countries; the end of the mergers-and-acquisitions boom; and the decline in Japanese investments abroad. Against the backdrop of this world-wide decline in investment flows and inflows to developed countries, investment flows to developing countries had increased by 25 per cent in 1991 to reach $36 billion, and in 1992 these might have increased further to some $40 billion. He attributed this development to the strong performance of countries in Asia and the resurgence of economic growth and the more open framework for transnational corporations, including privatization initiatives, in Latin America and the Caribbean. Although investments in Africa had increased, the level remained low and the bulk of those investments were concentrated in countries with natural resource endowments. Foreign direct investment in the least developed countries had also grown marginally but the level remained low - less than a quarter of inflows to Hong Kong. Like the developing countries, Central and Eastern Europe had continued to attract investments by transnational corporations, although at a slower pace in comparison to previous years. The strategies of transnational corporations had stressed the importance of the region from a long-term perspective, given the size of their domestic markets, their proximity to the markets of the European Community and the availability of natural resources. The unprecedented growth of investment flows in the 1980s and their decline in 1991 and 1992 had been attributed to the interplay of cyclical, structural and policy-related factors. The Chief of the Research and Policy Analysis Branch mentioned the ongoing liberalization of foreign-direct-investment and trade regimes, the continuing expansion of regional integration schemes, such as the Single Market in the European Community (and its further expansion to the European Economic Area) and the proposed North American Free Trade Agreement had exerted a positive stimulus to investments by transnational corporations. He cited a number of factors that would encourage a further increase in investment flows by transnational corporations in both equity and non-equity forms: the scope for further liberalization in the regulatory framework for foreign direct investment in some countries and sectors, particularly in the services area; the increasing maturity of the stock of foreign direct investment, leading to higher capacity for generating future earnings for reinvestment; and the continuous effort by transnational corporations to organize international production in a globally or regionally integrated fashion, facilitated by innovations in information and communications technologies. The changing organization of international production had important implications for policies adopted by countries to attract foreign direct investment. Efforts needed to be focused on higher value-added activities, targeted to specific functions and geared towards non-equity forms, and particular attention should be paid to services. In addition to those national efforts, host countries needed to take a holistic approach in their external economic policies to benefit from the emergence of an integrated international production system.

3. Many delegations from developed and developing countries took note of the decline in world-wide investment flows in 1991 and 1992. While this development had been attributed by a number of delegations from developed and developing countries to cyclical factors associated with the downturn in economic activity, a number of delegations from developed countries emphasized that structural and policy-related factors had also played an important role. A number of

delegations from developed countries also drew attention to the combination of those factors in explaining the level of inflows to their countries. In the midst of this slow-down in world-wide investment flows a number of delegations from developed and developing countries reiterated the important role of transnational corporations in the world economy, particularly in the emergence and development of an integrated international production system. A delegation from a developed country stated that such an integrated international production system was not a recent phenomenon.

4. A number of delegations from both developed and developing countries had the positive impression that the level of investment flows to developing countries continued to increase. A delegation from a developing country expressed concern about the implications that the decline in world-wide investment flows had for investments in developing countries. One delegation, speaking on behalf of a number of other delegations, questioned whether the increasing inflows to developing countries represented a long-term tendency. Some delegations expressed optimism that increasing inflows to developing countries and Central and Eastern Europe represented a long-term trend, given the significant improvement in economic indicators in Central and Eastern European countries and the unparalleled privatization processes and investment incentives that were under way in that region. In addition, barriers to cross-border investments were continuing to fall and privatizations were adding new stimuli to the involvement of transnational corporations in developing countries. A number of delegations from developing countries emphasized reforms of policies towards liberalization in an increasing number of countries, combined with regional and subregional economic integration programmes, as additional contributory factors to the sustained investment flows necessary for growth, technological modernization and increased participation of developing countries in the world economy. However, a number of delegations from developing countries and Central and Eastern Europe stated that the vigorous pursuit of policies of liberalization and privatization by their countries had in some cases incurred high social and political costs and their modernization programmes had remained stalled due to lack of capital and technological know-how. Nevertheless, these delegations looked towards increased cooperation with transnational corporations. Several delegations from developing countries and one delegation from a developed country expressed concern that foreign direct investment in Central and Eastern Europe might negatively affect investments in developing countries, through investment diversion or diminution.

5. Many delegations from both developed and developing countries expressed concern that, despite the increasing inflows of foreign direct investment to developing countries, those inflows remained low by comparison to that in developed countries and remained highly concentrated in a small number of developing countries. Many delegations from developing countries expressed concern that Africa and the least developed countries continued to receive a meagre proportion of world-wide inflows of foreign direct investment and thus remain marginalized to the global economic mainstream, despite adopting open and free market policies and providing various incentives to attract foreign direct investment. Several delegations from developing countries stated that this situation exacerbated structural imbalances in the global economy as well as the slow-down of world economic activity.

6. Many delegations provided the Commission with updates on policy measures or legislative frameworks adopted to encourage and promote the positive role of foreign direct investment and transnational corporations in growth and development. Those changes were generally made to attain deregulation and reduce the bureaucratization of domestic economies, which, in addition to enacting broad domestic economic reforms and providing investments to enhance infrastructure, human capital and other favourable locational advantages, including the implementation of regional integration schemes, had been successful in attracting increasing amounts of foreign capital. One delegation from a developing country reported the appointment of a minister for investment, whose main task was to facilitate the attainment of a conducive internal economic environment for foreign direct investment. In the midst of increasing investment inflows into their country, a delegation from a developing country reported on the growth of local enterprises that had accumulated experience to become transnational corporations, with their own unique characteristics.

7. Despite the relative success on the part of developing countries and countries of Central and Eastern Europe to attract increasing levels of foreign direct investment, a number of delegations from those regions perceived problems and bottlenecks in attracting further increases in investment flows from transnational corporations. One delegation from a developing country pointed to the strain on infrastructure facilities and lack of skills of the labour force as problems in encouraging the growth of foreign direct investment in more high-technology and more capital-intensive industries. A delegation from a developing country expressed concern that implementation of structural reform had been difficult because of the unfavourable world trading environment that did not ensure adequate access to markets in developed countries. The timely and equitable conclusion to the negotiations on the Uruguay Round was also considered crucial by a number of delegations from developing countries.

8. Considerable discussion took place on further actions to be taken at the national, regional and multilateral levels to enhance the role of foreign direct investment and transnational corporations in economic development. One delegation from a developed country noted that it was essential for the Commission to concentrate efforts on stimulating wealth-creating investments to favour the rapid return of sustained, non-inflationary global growth and to examine the role of investments in development since that constituted an essential aspect of relations between countries. Another delegation from a developed country pointed to the need for efficient functioning of markets and the curtailment of restrictive business practices that blocked market forces. However, a delegation from a developed country pointed out that actions taken by different countries were not equally important in attracting foreign direct investment. A delegation from Central and Eastern Europe pointed to the need for an enabling framework governing the relationship between transnational corporations and host countries, which would include the establishment of property rights, including intellectual property rights; the lifting of sectoral restrictions imposed on foreign direct investment; and the relaxation of domestic rules governing profit remittances abroad or capital repatriation. In that respect, the delegation stated that multilateral understandings at the global and regional levels might also be useful, particularly in matters concerning competition policies. A delegation from a developed country, speaking on behalf of other delegations, stated that all countries should aim at establishing a climate of stability and predictability to facilitate investment

flows, particularly to developing countries. A delegation from a developing country maintained that the relationship between transnational corporations and developing countries must be based on mutual benefit and that, in that respect, the concept of transparency with regard to transnational corporations activities in host countries should be consistently and conscientiously applied and the laws and legislative provisions of both home and host countries should be respected. In the context of the rise of an increasingly integrated international production system, several delegations from both developed and developing countries addressed the need to further increase the share of developing countries, particularly the least developed countries, in global investment flows in order for transnational corporations to fulfil their objectives as engines for growth. In addition, several delegations from developing countries pointed to the need to improve the response capacity of their countries through assistance and cooperation programmes that addressed the specific necessities of regions and countries. In that respect, a delegation from a developed country emphasized that, in Africa, the issue of foreign direct investment should be addressed in the wider context of the economic and social development of the region. Economic development through activities of the private sector was one of the key themes of the forthcoming Tokyo Conference on African Development. A delegation from Africa expressed support for the initiative to support and promote foreign direct investment in Africa. Another delegation from a developing country expressed the need to assist developing countries in building capacities in the areas of technology, management know-how and improving quality of manpower resources necessary for their long-term growth and enhanced transnational corporation involvement, as well as the need to promote and establish linkages with domestic small- and medium-scale firms as sources of raw materials, parts, components and services that would enhance the competitiveness of transnational corporations, while exploiting greater synergies between local and domestic firms.

9. A number of delegations from developing countries maintained that transnational corporations also had a role to play in enhancing their contribution to world economic development. One delegation from a developing country suggested that home countries should adopt the necessary fiscal and legislative measures to induce transnational corporations to increase their investments and to devote a portion of their research-and-development activities to developing appropriate and affordable technology for the least developed countries. In that context, a delegation from a developed country elaborated on the laws adopted to enhance and promote foreign direct investment in developing countries. Another delegation from a developing country emphasized that transnational corporations should be more sensitive to the needs and aspirations of developing countries by adopting long-term perspectives on the economic opportunities that developing countries could offer. In addition, those firms should encourage greater local equity participation by promoting joint ventures and their listing in the local stock-exchange markets and could play a positive role in resource conservation by engaging in downstream processing activities which also increased value-added activities and the earning capacities of host countries.

10. Discussions also centred on the changing relations between transnational corporations and host countries. One delegation from Central and Eastern Europe pointed out the important reciprocal advantages that could be generated by cooperative, non-confrontational relationships with transnational corporations.

At the same time, transnational corporations had come to give more attention to sensitive national issues and devising ways to achieve their goals without unduly harming host countries, but according to that delegation, there was still scope for further improvement of those relations, given the advantages that both sides could gain. A number of delegations from developing and developed countries proposed that an item on the present situation of foreign investment in the least developed countries be included in a future session of the Commission and that special studies should be undertaken to identify the root causes behind the low levels of foreign direct investments in those countries, and make the necessary recommendations. A delegation from a developed country also noted that the quantitative importance of foreign direct investment was better gauged by analysing stock data than by analysing flow data. However, even that was inadequate, given the role of transnational corporations in non-equity relationships. Another delegation from a developed country also stressed that studies should be undertaken on the qualitative impact of foreign direct investment, linking foreign direct investment to technology transfers, know-how, research and other important economic variables.

11. At its 1st and 2nd meetings, on 5 April 1993, the Commission had heard presentations by three expert advisers on transnational corporations in the world economy and trends in foreign direct investment in developing countries. The expert advisers had outlined the evolution of a new growth trajectory of the world economy, characterized by long-term structural changes in production and pivotal advances in technology. In both respects, transnational corporations, particularly through their foreign-direct-investment activities, were recognized to have an instrumental role, although one that needed to be evaluated in the broader development context.

12. Ms. Sylvia Ostry outlined two aspects of the new growth path which distinguished it from previous periods of economic growth. First, locational advantages were increasingly being defined in a global context. Second, at the enterprise level, organizational changes implied a shift away from hierarchical relations towards looser firm structures. In addition, Ms. Ostry emphasized the need to establish a stable and credible international system of governance as a backdrop to increased investment, including foreign direct investment.

13. Mr. Osvaldo Sunkel, in his presentation, introduced a third component shaping the new growth path. The world economy was becoming more than simply the sum of its national components. That was particularly true of foreign direct investment in which the evolving international production system was closely intertwined with the global investment Triad of Japan, the United States of America and the European Community. Mr. Sunkel noted that the involvement of transnational corporations in privatization measures in developing countries often produced short-term dislocations because of the need to restructure the acquired firms, with only long-term benefits.

14. Both expert advisers recognized that the further consolidation of those developments, including through a more prominent role for transnational corporations, would not occur without dislocation and conflict. Careful management was all the more urgent as those developments were taking place against a sombre macroeconomic and political backdrop.

15. Mr. Sanjaya Lall and Mr. Sunkel stated that an appropriate national policy response must be an integral component of the new growth trajectory. Both recognized that market-friendly reforms, introduced over the course of the past decade in many developing countries, had played a crucial role. However, as more countries liberalized, legislative differences would diminish as a means of attracting foreign direct investment. Moreover, both experts stated that liberalization, while expanding the opportunities for foreign direct investment, did not automatically guarantee the desired growth path. Mr. Lall observed that increased foreign direct investment was consistent with, and could further reinforce, either a low technology/low skill/low wage or a high technology/high skill/high wage growth regime, and Mr. Sunkel noted, from the Latin American experience, that a considerable amount of foreign direct investment during the 1980s had taken the form of acquisitions and financial investments which did not in themselves expand capacity or enhance productivity and might well be of a short-term nature. Indeed, all the experts warned against placing too great an emphasis on foreign direct investment.

16. Mr. Lall stated that the benefits from liberalization and globalization would require strengthening the host-country domestic economic base, including a pro-active role for the State in building up capabilities and infrastructure to sustain long-term growth. In particular, he emphasized science and technology as a critical component in creating desirable locational advantages in the emerging international production system. Mr. Lall recognized that building capabilities in that area would be a gradual process of up-skilling, but that only through concerted effort by host country Governments would the successful transfer of technology, including transfer by transnational corporations, to developing countries be realized. Once established, an innovative environment would attract investment, both domestic and foreign, with cumulative benefits for the whole economy. The point was reinforced by noting that newly industrializing economies in Asia, although successfully upgrading into higher value-added activities, continued to receive more foreign direct investment in traditional industries than did low-wage countries in, for example, sub-Saharan Africa.

17. In his concluding remarks, the Chief of the Research and Policy Analysis Branch of the Transnational Corporations and Management Division summarized the main issues discussed and the similar and divergent views expressed during the discussion. He identified the five main issues discussed: the emergence of an international production system, the decline in world-wide investment flows, the increasing relative importance of developing countries as recipients and sources of foreign direct investment in the world economy and the policy framework governing foreign direct investment.

Action taken by the Commission

18. The Commission:

(a) Took note of the reports of the Secretary-General on trends in foreign direct investment (E/C.10/1993/2), on the growth of foreign direct investment in the 1980s (E/C.10/1993/3), on the emergence of integrated international production (E/C.10/1993/4) and on the universe of transnational corporations (E/C.10/1993/11);

(b) Requested that the Secretary-General continue the programme of research on transnational corporations in the world economy and flows of foreign direct investment to developing countries and disseminate the results of such research through various publications, including the World Investment Report and the World Investment Directory;

(c) Requested the Secretary-General to submit to the Commission at its twentieth session reports on trends and issues in foreign direct investment in the globalizing world economy.